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072356Z Oct 05

C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 004125

SIPDIS

DEPT FOR EAP/TC  
DEPT PASS AIT/W

E.O. 12958: DECL: 10/06/2015

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SUBJECT: TAIWAN GOVERNMENT BAILS OUT HIGH-SPEED RAIL AGAIN

REF: TAIPEI 3779

Classified By: AIT Director Douglas H. Paal, Reason 1.4 d

1. (SBU) Summary. Taiwan has leaned on government entities to bail out the financially strapped Taiwan High-Speed Rail Corporation (THSRC). The China Aviation Development Foundation (CADF), the major shareholder of China Airlines, and the CTCI Foundation, both Taiwan government entities, will purchase a total of NTD 7.5 billion (about USD 225 million) worth of preferred stock in THSRC. The bail-out spawned criticism and even a suit by aviation labor associations against CADF. The Executive Yuan (EY) formed a task force on October 3 to monitor the project. The government has also obtained a seat on the board of directors. The Taiwan government has avoided having to buy back the high-speed rail project, but THSRC still faces financial challenges. End summary.

THSRC Appeals to EY  
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2. (U) Shortly after announcing a one-year delay in completion of Taiwan's high-speed rail project on September 8, 2005 (reftel), Nita Ing, THSRC's chairman, went to Taiwan Premier Frank Hsieh on September 26 to seek financial assistance from the government. THSRC has had persistent difficulty raising funds from investors. It has been forced to revise the financing agreement with its consortium of creditors more than a dozen times.

3. (U) The government has already provided NT\$ 12.5 billion (about USD 375 million) to THSRC through state-owned Taiwan Sugar Corp., the Bank of Taiwan, and the Land Bank of Taiwan. More recently, China Steel Corp. invested an additional NT\$ 3.2 billion (about USD 95 million) in THSRC in April 2005. In 2002, the Legislative Yuan passed a resolution limiting total state-owned enterprise investment in the project to 12 percent of THSRC's paid-in capital. However, on September 28, the press reported that a government official had indicated that the resolution was nonbinding and the EY would direct state-owned enterprises to further invest in THSRC.

Unlikely Suspects Provide the Funds  
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4. (U) On September 29, KMT Legislator Lai Shyh-bao revealed in a Legislative Budget Committee meeting that the Taiwan government's Civil Aviation Development Fund (CADF), which owns over 65 percent of the shares in China Airlines (CAL), would invest NT\$ 4.5 billion (about USD 135 million) in THSRC. According to Lai, CADF would finance the investment by selling 300 million shares of CAL stock. The Taiwan press also reported that CADF held an unscheduled board meeting to change the foundation's charter in order to legitimize the purchase of THSRC shares. The organization added the assistance of "national critical construction" to its primary goal of aviation development.

5. (U) The Taiwan government's CTCI Foundation, formerly known as China Technical Consultants Inc., will also invest NT\$ 3 billion (about USD 90 million) in THSRC, making up the rest of THSRC's NT\$ 7.5 billion (USD 225 million) shortfall. The CTCI Foundation, founded in 1959 has historically engaged in research and design support for a range of industries in

Taiwan, especially petrochemicals, energy and environmental protection. Although the foundation has large financial resources, the Taiwan government has not generally used it to invest in targeted projects or industries.

16. (SBU) Comment: The Chen Administration may have selected CADF and the CTCI Foundation as the conduits for further investment in THSRC in order to comply with the LY resolution intended to freeze further state-owned enterprise investment in the firm. The administration could argue that CADF and the CTCI Foundation are not technically state-owned enterprises but are rather Taiwan government entities. Furthermore, some observers have speculated that administration officials may have hoped that investment from these entities would attract less attention than financing from more typical government investment conduits like the Executive Yuan Development Fund. End comment.

#### Criticism and Closer Scrutiny

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17. (U) There has been a strong negative reaction from a range of interests in Taiwan. Some domestic air carriers object to the use of CADF, which some feel has done little to assist local carriers, to bail-out a future competitor. The China Airlines Employees Union and Federation of Aviation Employees filed suit against the board of CADF on October 4. Others object more broadly to the use of additional government funding to bail-out a build-operate-transfer project that was intended to relieve the government of construction costs for the high-speed rail.

18. (U) In a move likely aimed at muting such criticism, the Executive Yuan established a task force on October 3 to monitor the high-speed rail. The interagency group will meet every two weeks and representatives from the task force will attend important THSRC meetings. In addition, Premier Hsieh asked THSRC's Ing to add a seat for a government representative on THSRC's board. Deputy Director General Lee Yu-ling of the Directorate General of Budget, Accounting and Statistics was named to the new seat.

#### Comment - BOT or JV?

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19. (C) With a major infusion of funds and now a seat on the board, the Taiwan government once again may have escaped having to buy back the high-speed rail project at a cost of over NT\$ 300 billion (about USD 9 billion) and then take over construction. However, it may be more accurate to call the high-speed rail project a government joint venture rather than a build-operate-transfer project. And the drama isn't over yet. Inauguration of the program was postponed last month from October 2005 to October 2006. However, an AIT contact associated with construction of the project recently reiterated his prediction that rail service would not be fully operational until mid-2007. Despite the latest government funding, the troubled THSRC still has financial challenges ahead and the Chen Administration may need to use government funding yet again to bail it out. The torrid business environment and optimistic economic assumptions made when THSRC was conceived have greatly changed in recent years. The new EY task force would do well to reexamine assumptions and make the government's procedures orthodox and transparent. End comment.

PAAL